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INITIAL STUDY ON SUSTAINABILITY-RELATED WEBSITE DISCLOSURES IN TERMS OF THE SUSTAINABLE FINANCE DISCLOSURE REGULATION

12 April 2023

Contents

Table of Abbreviations

ESG	Environmental, Social and Governance
EU	European Union
ESMA	European Securities and Markets Authority
FA	Financial Adviser
FMP	Financial Market Participant
IBIP	Insurance-based Investment Product
MFSA	Malta Financial Services Authority
PAI	Principle Adverse Impacts
SFDR	Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector
RTS	Regulatory Technical Standards supplementing the SFDR, Commission Delegated Regulation (EU) 2022/1288

Introduction

Overview

Sustainable investment is a fast-growing area of investment management, and the subject of an ambitious EU legislative framework on sustainability risk integration and disclosure. National competent authorities within the EU are putting more emphasis on the need to take into account environmental, social and governance considerations, especially climate change related risks in business activities, and have highlighted them as key priorities in their supervisory mandates.

Specifically, Regulation (EU) 2019/2088 (the "SFDR") assigns the Member States' national competent authorities the duty of monitoring compliance by financial market participants ("FMPs") and financial advisers ("FAs") with a number of disclosure requirements. The MFSA is the competent authority in Malta for the purposes of the SFDR.

The SFDR is directly applicable and most of its provisions have started applying from 10 March 2021. It aims to address two complementary objectives; that of increasing transparency of sustainability-related disclosures and to increase comparability of the disclosures for end investors. This would provide investors with greater insight into sustainability risks pertaining to their investments and facilitate more informed decision-making.

In line with the United Nations' 2030 Agenda for Sustainable Development, and the European Green Deal, sustainable finance was selected by the MFSA as one of its supervisory priorities. From an early stage, the MFSA has been communicating its expectations with respect to the SFDR legal framework by means of various circulars (in particular, in the MFSA Report of 12 April 2022 on Operational and Compliance Readiness by Financial Market Participants and Financial Advisers) whereby it has emphasised that entities were required to take the necessary steps to ensure compliance and enhance their operational preparedness in complying with the SFDR requirements.

The MFSA's Supervisory Work

The MFSA carried out a supervisory analysis to assess the extent to which the website disclosures of the following licence holders comply with the SFDR requirements:

- investment firms and credit institutions, which provide investment advice and/or portfolio management services;
- insurance undertakings which make available insurance-based investment products; and
- fund managers,

(together referred to as the *"entities"*).

This analysis was performed by the MFSA's Conduct Supervision and Investment Services Supervision functions, and was based on the information reported by FMPs and FAs in the context of MFSA's 2021 self-assessment questionnaire as well as desk-based reviews of the disclosures by a sample of licence holders on their websites between September and December 2022.

The outcomes of this review are now being reported in this document with further feedback regarding the standard of compliance expected from licence holders in the context of the foregoing.

IMPORTANT NOTE: This review and related supervisory feedback does not take into consideration the Regulatory Technical Standards,[1] supplementing the SFDR, which *inter alia* contain further details with regards to the SFDR website disclosures, as these have only become applicable as from 1 January 2023. Therefore, the examples of good and undesirable practices referred to in this publication should be considered without prejudice to the specific disclosures to be made under the SFDR RTS and any disclosure standards that have become applicable in this regard.

All entities within the scope of this Report are expected to take into account the observations set out in this document when implementing the requirements of the SFDR.

[1] Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022, including the mandatory templates set out in Annexes thereto.

Scope, Purpose and Structure of this Publication

This document is addressed to all entities mentioned above and outlines the MFSA's observations and corresponding preliminary compliance expectations regarding website disclosures, so that relevant entities can make the necessary improvements to the information published on their websites.

Section 1 of this document sets out the MFSA's observations derived from reviewing website disclosures of investment firms, credit institutions and insurance undertakings. It also provides examples of good practices and areas for improvement.

Section 2 of this document sets out the MFSA's observations and corresponding high-level expectations derived from reviewing the website disclosures of Fund Managers.

Section 3 indicates the way forward in respect to these expectations.

Section 1: MFSA Observations with Respect to Investment Firms and Insurance Undertakings acting as Financial Market Participants/Financial Advisers

1.1 Article 3 of the SFDR on Transparency of Sustainability Risk Policies

Pursuant to Article 3 of the SFDR:

(a) FMPs shall publish on their websites information about their policies on the integration of sustainability risks in their investment decision-making process; and

(b) FAs shall publish on their websites information about their policies on the integration of sustainability risks in their investment advice or insurance advice.

Main Observations

In their website disclosures some FMPs and FAs referred to policies on the integration of sustainability risks in their investment decision-making process or in their investment advice or insurance advice, respectively. However, it was observed that policies disclosed in terms of risk management and Principle Adverse Impact ("PAI") considerations are often confused or used interchangeably; and this should not be the case.

Some of the entities also claimed, in a generic manner, that they integrated sustainability risks in investment decision making, and made a general reference to ESG factors to identify the source of these ESG Risks. However, most often it does not clearly emerge what are the key ESG Risks for the particular entity and what is the entity's methodology/procedures in analysing Manufacturers (or Issuers) or the products to distribute in terms of ESG risk considerations. On the other hand, some entities sought to provide an indication of the ESG risks being considered, however such entities failed to provide more detailed information on how they intend to take such risks into consideration in their investment decisions.

A large proportion of entities merely claimed that sustainability risks are not deemed to be relevant by them, without providing clear and sufficient reasons in this respect. However, some of the entities which claimed that they do not integrate or take sustainability risks into account did provide some reasons as to why they do not do so.

Examples of Good Practices

i. Entities supplemented their main SFDR website disclosures, also with links to their own policies incorporating sustainability elements.

ii. Entities established, as part of their governance structure, a separate committee for the purposes of identifying and overseeing ESG Risks and/or ensuring the integration of sustainability elements in their processes and procedures.

Examples of Undesirable Practices

i. It is not considered acceptable that an entity does not clearly outline in its website disclosures the approach adopted by it in relation to the integration of sustainability risks and simply makes a generic statement and/or merely refers to a relevant policy of the entity.

   By way of example, it is not considered sufficient for an entity to state in a generic manner that it has incorporated responsible investing within its advisory services and has considered ways in which it can successfully integrate sustainability investment solutions within its investment advisory process, without explaining in further detail how it will do this.

ii. A general weakness observed is that there is usually no indication from FMPs and FAs, which claim that they do not integrate sustainability risks, as to whether they intend to integrate sustainability risks in the future or otherwise, and if so an estimate as to when they intend to do so.

iii. The Authority also noted certain instances where entities stated that they are still assessing sustainability risks, without providing any specific reason why this was not done before or when the sustainability risks will be integrated.

iv. It is noted that for the purposes of satisfying the requirements laid down by Article 3 of the SFDR, certain entities placed the onus of integrating sustainability risks on the entity's external/third-party investment managers. This approach is deemed to be insufficient and ambiguous. The entity's expectations of its external managers, with regard to sustainability considerations, are ultimately reflected in the entity's final decision-making process, and therefore should be disclosed as such.

v. Even though some FMPs stated that they do not currently integrate sustainability risks in their investment decision making processes, they do not exclude that in the future, either in respect of certain Products and/or prospective Clients, they could incorporate ESG considerations and perform an assessment of sustainability risks to the extent relevant. However, any such statements should not be made in a generic manner and need to include further information including an estimate as to when the FMP intends to integrate the sustainability risks.

1.2 Article 4 of the SFDR on Transparency of Adverse Sustainability Impacts at Entity Level

The underlying objective of Article 4 of the SFDR is to encourage FMPs to pursue more sustainable investment strategies in terms of reducing negative externalities on sustainability caused by their investments. FAs are also encouraged to give more attention as to how the consideration of negative externalities is integrated in their investment or insurance advice.

As the obligations for FMPs and FAs to publish and maintain on their websites information on PAI considerations are set out in SFDR requirements entered into force on 10 March 2021 (*vide* in particular Article 4 of the SFDR), FMPs and FAs should comply with the said disclosures, or ensure that reasons for not doing so are outlined, including, where relevant, information as to whether and when they plan to consider such adverse impacts.

1.2.1 Entities claiming that they consider PAIs of Investment Decisions and Investment/Insurance Advice, on Sustainability Factors - Main Observations

Pursuant to Article 4 of the SFDR, FMPs shall, where they consider PAIs of investment decisions on sustainability factors, publish and maintain on their websites a statement on due diligence policies with respect to those impacts.[2] Article 4(1) provides for a *'comply or explain'* mechanism. However, in accordance with Article 4(3) and 4(4)[3] of the SFDR, large FMPs (on a solo or group basis) have an obligation to publish and maintain the relevant information on the website.

From an analysis of the website disclosures, it emerged that some entities fail to make specific reference to PAIs and/or do not provide a clear explanation as to the said PAIs. For instance, it is merely claimed in general statements that the entity integrates sustainability risks in its investment decision making or in its sustainability risk profile, or that it adopts an ESG negative screening or exclusion list. However, such website disclosures do not provide sufficient explanation as to how they consider these impacts, that is, a clear description of the methodology/process adopted by the entity in this respect. Most of the disclosures noted are quite generic and vague and do not feature clear descriptions of what the PAIs considered are and what actions are taken in this regard.

With respect to the consideration by FAs of the adverse impacts of investment decisions on sustainability factors in the entities' investment advice or insurance advice, most of the website disclosures included generic statements merely stating, for instance, that information provided by manufacturers in relation to ESG elements are to be integrated in the financial advice provided by the FA.

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[2] This shall include, at least, information about their policies on the identification and prioritisation of PAIs and sustainability indicators; a description of the PAIs (and of any actions taken or where relevant, planned in relation thereto); and a reference to the FMPs' adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting and, where relevant, the degree of the FMPs' alignment with the objectives of the Paris Agreement.

[3] Article 4(3) SFDR applies to financial market participants exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year; Article 4(4) SFDR applies to financial market participants which are parent undertakings of a large group referred to in Article 3(7) of Directive 2013/34/EU exceeding on the balance sheet date of the group, on a consolidated basis, the criterion of the average number of 500 employees during the financial year.

Pursuant to Article 4(1) SFDR, FMPs who consider PAIs of investment decisions on sustainability factors are also, amongst other matters, required to describe whether and to what extent they adhere to *"responsible business conduct codes and internationally recognised standards for due diligence and reporting and, where relevant, the degree of their alignment with the objectives of the Paris Agreement."*

It was observed that most of the PAI disclosures/statements assessed did not make any indication or reference to this. On the other hand, some entities merely made a generic or high-level disclosure whereby the Paris Agreement was vaguely referred to. Such disclosures are lacking in quality and detail since none of the entities actually provide any specific information related to their degree of alignment with the objectives of such Agreement.

Examples of Good Practices

i. Entities, as part of the website disclosure, supplemented their main SFDR website disclosures on PAIs also with links to their own policies incorporating ESG or sustainability-related elements.

ii. Entities provide details on the approach and methodology adopted in the website disclosure itself.

    For instance, a particular entity, in its disclosure, made specific reference to PAIs in its ESG investment process framework. It also indicated that PAIs will have an important role in determining the exclusion of some investments and in assessing the client ESG preferences; and also stated that it intends to use (where available) the breadth and depth of a widely used commercial financial data provider.

    Other examples positively noted were when selected entities clearly indicated the actions being taken in their investment strategy, such as that of not investing in companies that derive a certain percentage of their revenue from coal-produced energy.

iii. Website disclosures were clearly dated and/or which included a reference date for any changes made.

A few entities also clearly outlined the annual period covered by their SFDR disclosure/statement. This practice of including the reference period of the disclosure/statement is considered key, particularly since this forms part of the requirements outlined in the SFDR RTS and in the Annexes thereto, applicable as from 1 January 2023.

Examples of Undesirable Practices

i. Some entities which appear to consider PAIs merely provide very generic statements with no further explanation. It is considered insufficient for an entity to merely state that as part of its commitment to sustainable and responsible investing, it considered ways in which it can successfully integrate sustainability investment advisory process – that is, without providing further a clear explanation and description of the process/methodology of its PAIs consideration.

ii. Some entities only made generic statements stating, for instance, that they do not have in place separate ESG processes; or claimed in a very general manner that, where applicable and appropriate, they shall favour products that promote and provide solutions that are consistent with ESG factors. These types of generic statements are not clear and are deemed insufficient.

As a general statement, some entities offering investment advice also claimed that they shall limit advice in relation to products which have negative ESG impacts on ESG.

The Authority underlines that investment firms and credit institutions providing investment advice and portfolio management services are required to comply with the requirements of the Conduct of Business Rulebook (vide MFSA Circular of 29 July 2022) which incorporate requirements emanating from the: Commission Delegated Regulation (EU) 2021/1253 relating to the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms; as well as ESMA Guidelines covering certain aspects of the MIFID II Suitability Requirements[4].

iii. It was also noted that in the disclosures made by FMPs and FAs pursuant to Article 4, in some cases the information disclosed on adverse impacts is also being confused with risk-management related information, such that some entities are confusing the terms '*sustainability risks*' under Article 3 of the SFDR and the terms *'PAI'* or *'adverse impacts'* in terms of Article 4 of the SFDR and erroneously used interchangeably. The Authority notes that this should not be the case and that a clear distinction is to be made between these different types of information to be disclosed.

1.2.2 Entities claiming that they 'do not' consider PAIs of Investment Decisions and Investment/Insurance Advice, on Sustainability Factors

It was observed that around half of the FMPs do not consider the PAIs of their investment decisions on sustainability factors under Article 4(1)(b) of the SFDR.

It is to be recalled that, pursuant to Article 4 of the SFDR, FMPs shall, where they *do not* consider PAIs of investment decisions on sustainability factors, publish and provide *clear reasons* as to why they do not do so, including, where relevant, information as to whether and when they intend to consider such adverse impacts.

Similarly, FAs shall disclose information as to why they do not consider adverse impacts of investment decisions on sustainability factors in their investment advice

[4]In the context of the suitability assessment, entities are reminded that they are required, amongst other matters to:

- incorporate the collection and analysis of the necessary information about the client's or potential client's ESG/sustainability preferences;
- integrate considerations of the client's individual sustainability preferences into the entity's client suitability assessments and product selection process;
- update and/or review the process of collecting sustainability preferences from clients;
- integrate client's suitability preferences as a top-up to the suitability assessment;
- keep adequate record-keeping;
- update and/or review processes relating to ESG data sourcing, including those related to obtaining reliable ESG information from product manufacturers; and
- provide appropriate training to relevant staff, including guidance on assessing client's sustainability preferences.

or insurance advice, and, where relevant, include information as to whether and when they intend to consider such adverse impacts.

However, in its assessment the Authority noted that the extent of FMPs choosing to explain and provide clear reasons as to why they do not consider the adverse impact of their investment decisions under Article 4(1)(b) of the SFDR and when they intend to do so, is quite minimal. In fact, the extent of the disclosures where FMPs *'do not'* consider adverse impact of investment decisions on sustainability factors is lacking in detail since, entities largely fail to provide clear reasons for why they do not do so.

In this respect, it was observed that some of the FMPs and FAs which stated that they do not consider PAIs fail to provide sufficient information to clearly explain their position. Additionally, some of the reasons provided by those entities which sought to explain why they do not consider PAIs were considered to be generic and not sufficiently detailed.

Examples of Undesirable Practices

i. Some FMPs which do not consider PAIs merely stated in their website disclosure general statements such as the following, **without providing relevant reasons** for adopting this approach:
   - the entity does not undertake an assessment of the PAIs of its decisions on ESG Factors;
   - information on ESG Factors does not form part of its decision-making process;
   - sustainability Risks are not deemed to be relevant by the entity.

   However, this is not deemed sufficient, since it is expected that FMPs should, where relevant, include the information referred to in Article 4(1)(b) of the SFDR setting out clear reasons as to why they do not consider PAI and when they intend to consider such adverse impacts at entity level (that is, show concrete commitments to consider PAIs going forward).

ii. In the context of entities which do not consider PAIs, some FMPs did not exclude that they would change their approach in the future depending on for instance, the legal framework, as well as the entity's business decision. In this respect, there were a few entities which, although they do not consider PAIs, in their website disclosure and/or sustainability policy, they stated for instance, that:

- given the importance of sustainability criteria and ESG, the entity undertakes to integrate ESG criteria and PAIs into its strategies in the near future;
- the entity may possibly consider such PAIs in respect of future mandates so that it will, in respect of certain products and, or clients onboarded in the future, incorporate ESG considerations and make an assessment of sustainability risks to the extent relevant to the nature of the product; or of the client's mandate or appetite.

However, the Authority would like to emphasise that entities making such type of statements, relating to the possibility that they will re-think their strategy to start considering PAIs, should include further information including providing an estimate as to when the entity intends to consider PAIs of investment decisions on sustainability factors and should update the website disclosure and their relevant processes and procedures accordingly.

1.2.3 Whether Website Disclosures made in accordance with Articles 3 and 4 of the SFDR are 'Easy and Straightforward' to Find

From the Authority's assessment, it was noted that in the case of FMPs, around half of the entities' website disclosures pursuant to Articles 3 and 4 of the SFDR were deemed to be *"easy and straightforward"* to find. Essentially this means that the information to be disclosed need to have a title with the language being closely aligned with SFDR terminology and is published in a manner which is prominently portrayed in an easily accessible area of the website.

In fact, some entities placed the statement/disclosure under a specific tab on sustainability on the website or within the section containing 'legal documents' or 'legal disclosures'. Other entities chose to make a specific heading clearly related to sustainability and placed it under a sub-heading/tab related to services the entity offers, while others made the statement linked to the *'About us'* section or *'Useful Information'* tab.

However, it emerged that some SFDR website disclosures/statements are considered not to be sufficiently visible and difficult to access from the main website page. This is often due to the positioning of these website disclosures which are, for instance, either placed at the bottom of the website and/or the links to the relevant page appear to be otherwise concealed and hidden. Moreover, a search of such sub-pages is not very user-friendly and often subject to long search paths.

It has been noted that, in many cases, users browsing the website are not easily directed to the specific webpages that contain SFDR related disclosures. A client looking to assess ESG related considerations would not be directed to or encouraged to access such information. On the contrary, even an investor that would be specifically looking for such information would find it difficult, as the links to such disclosures are buried deep into the website or are located in marginal web pages. Furthermore, such disclosures would refer to other policies (such as the remuneration policy) without providing a direct link to these. It was also noted that an entity may spread their disclosures over a number of different pages instead of having them listed under a single page, making it hard for potential investors to easily assess the required information.

Examples of Good Practices

As a starting point, and in light of the above, a commendable practice would consist of, a clear reference to SFDR disclosures once a website user has selected the webpage referring to life insurance or to investments, unless this can be placed on the website's main landing page. This prominent reference would guide the user to a dedicated page (or statement) which would comprehensively make clear all relevant sustainability related disclosures. It is also considered a good practice to include SFDR disclosures within the 'legal documents' or 'legal disclaimers' section of the entity's website, if this is available.

Examples of Undesirable Practices

There were few entities which in their replies to the MFSA Survey claimed that the disclosure was published on its website, but to access the website to view the disclosure one needs authorisation from the entity itself. **The MFSA would like to reiterate that any website disclosure needs to be made publicly available and that any SFDR disclosures published on the entity's website with limited access on a dedicated section which can only be viewed via an investor login page is definitely considered as non-compliant with the SFDR obligations.**

1.2.4 Article 5 on Transparency of Remuneration Policies in relation to the Integration of Sustainability Risks

FMPs and FAs are required to include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks and shall publish that information on their websites. Such information shall be included in remuneration policies that FMPs and FAs are required to establish and maintain in accordance with sectoral legislation applicable to them.

Main Observations

It was noted that some entities did not make any reference to their remuneration policies in their SFDR disclosure/statement, while others made only very generic statements stating that the entity's approach to remuneration, as set out in its remuneration policy, does not encourage excessive risk-taking with respect to sustainability risks.

It was observed that some entities which claimed that they do not take into consideration PAIs, also referred to the fact that their remuneration policy will not be taking sustainability risk into account or that with such policy there is no risk of misalignment with the integration of the sustainability risks.

The majority of firms refer to their remuneration policies being consistent with the integration of sustainability risks, however it was noted that such disclosures were not always directly linked to the actual policy itself which may render such a disclosure not fully clear. In this case, if the remuneration policy is not readily and easily accessible, this would render the disclosure insufficient.

Examples of Good Practices

Where sustainability is referred to in the remuneration policy, the disclosure itself easily links to the complete remuneration policy, for ease of reference.

Examples of Undesirable Practices

It is not considered sufficient for an entity to merely state that it has considered PAIs fairly and objectively in alignment with its remuneration policy and internal governance framework. The website disclosure should also include information on how the entity's remuneration policies are consistent with the integration of sustainability risks.

1.2.5 Article 10(1) relating to Transparency of the promotion of Environmental or Social Characteristics and of Sustainable Investments on Websites

FMPs are responsible for assessing which financial products must comply with the provisions of the SFDR. Thus, where a financial product falls under Article 8 or Article 9 of the SFDR, FMPs must maintain on their websites certain information for each of these financial products to ensure proper compliance with the applicable disclosure requirements (such as, Articles 10 and 11 of the SFDR).

Main Observations

Overall, it was observed that **only very few entities** stated in their responses to the 2021 MFSA Survey and/or in their disclosures that they have Article 8 and/or Article 9 products under their management.

In so far as the insurance industry is concerned, in the context of insurance-based investment products it appears that presently there are no locally regulated manufacturers that are making available Article 8 and Article 9 products. This is possibly linked to the feedback received in the MFSA's survey of 2021 where the majority of insurance undertakings had indicated that they had not encountered any demand for such products. Despite this, some companies had indicated that they are willing to develop products within 24 months and this is therefore considered to be a continuously evolving situation.

In this respect, the Authority would like to point out that should an entity intend to amend any current products in order classify them as Article 8 and/or Article 9 products as defined under the SFDR, this would be deemed to be a *"significant adaptation"* of the existing product. Therefore, prior to the product being launched, it would need to be considered within the entity's product oversight and governance ("POG") arrangements, which are also required to consider sustainability factors, in order to address any potential impacts the adaptation may have on existing or potential customers.

Examples of Undesirable Practices

It was observed that in some instances, investment firms stated that they have under their management products which are explicitly labelled ESG, sustainable or with similar terms. In spite of this claim, on their website disclosure and its sustainability Policy there was no explicit, clear reference and explanation as to whether (in terms of the characteristics of the products) the entity is offering Article 8 or Article 9 products, or both, in accordance with the relevant SFDR disclosure obligations.

It is to be noted that an entity cannot simply and randomly label a product as sustainable, green or use other similar terminology, without classifying such product as either an Article 8 or Article 9 product, and consequently ensuring its compliance with all the relevant requirements of the SFDR framework and the

Taxonomy Regulation (Regulation (EU) 2020/852). The Authority would like to emphasise that this kind of practice is potentially misleading and is likely to constitute greenwashing[5].

[5]Greenwashing is broadly understood as a practice whereby Sustainability-related statements/declarations/communications regarding an Entity and/or a financial Product/Service may be misleading to consumers/investors as it does not faithfully reflect the underlying sustainability features or characteristics.

Section 2: MFSA Observations on Fund Managers' Sustainability-Related Website Disclosures

2.1 Location of Website Disclosures

Main Observations

i. Generally speaking, the SFDR website disclosures were not particularly easy to locate. Most disclosure tabs or links were not placed within the dropdown list available on the home page of the website. In other instances, the disclosures or relevant tabs were placed at the bottom of the home page and were written in small text that made it impossible for such disclosures or tabs to feature prominently on the website.

ii. Disclosures were often fragmented and incorporated in legal or general PDF documents, or else were combined with other information, such as privacy or engagement policy disclosures and, at times, included with risk management information.

iii. The description of the disclosure tabs did not always refer to 'ESG', 'SFDR', 'Sustainability', or similar terms, and this created yet another obstacle when attempting to locate the disclosures. By way of example, certain ESG disclosures were found under 'Insights', 'Regulatory', 'Licences' or 'Operating Capabilities' tabs. In fact, only a handful of Fund Managers had a dedicated section with the relevant heading ('Sustainability Disclosures', or similar wording) on their website.

iv. In limited instances, the Authority came across Fund Managers that did not have a website.

v. The Authority also observed Fund Managers whose website did not include any SFDR disclosures whatsoever. In such cases, the users of the website were invited to contact the respective Fund Manager via email or phone to obtain detailed disclosure documents or an ESG policy.

Expected Practices

i. It is expected that SFDR-related disclosures are published under a dedicated tab that can be accessed from the home page of the website, and that such tab is located in a prominent position on the website and is named in a manner that clearly suggests its relation to the SFDR disclosures.

ii. The SFDR requires disclosures to be published and kept updated on the website. The inclusion of detailed policies and downloadable material is acceptable, however the website disclosures themselves need to be clear and detailed enough to allow the user to acquire a basic understanding of the approach taken by the Fund Manager in respect of the sustainability risks and considerations.

iii. It is to be noted that website disclosures are mandatory, and thus the availability of a website to enable such disclosures is required.

iv. Fund Managers should use the sustainability-related website disclosures to expand on topics disclosed in pre-contractual documents, and to provide further information relevant to current and potential stakeholders.

2.2 Integration of Sustainability Risks

Main Observations

Article 3 of the SFDR requires in-scope Fund Managers to publish on their websites information about their policies regarding the integration of sustainability risks in their investment decision-making process. The Authority notes that, overall, Fund Managers were found to be compliant with most elements of the said requirement, with only 6 entities not having the disclosures stipulated in Article 3 of the SFDR.

The points included below highlight the Authority's observations with reference to the contents of Article 3 disclosures:

i. Most of the reviewed Fund Managers have not disclosed the integration of sustainability risks into their investment decision-making process. In addition, a number of disclosures did not specifically refer to the financial products under management and have not properly justified the exclusion of sustainability risks from the decision-making process.

ii. Where entities disclosed a commitment to integrate sustainability risks, often the disclosures did not clearly describe the integration of such risks. Such disclosures were found to be generic in nature, and not specific to the funds being managed. Furthermore, in many instances, the Authority observed that information on the analysis of the likely impacts of sustainability risks on the returns of the underlying funds was missing.

iii. Several Fund Managers disclosed that they performed no assessment of ESG factors in respect of individual investments, as they deemed the adverse impact of such factors on the performance of the investments to be limited. In such instances, the Authority found no details on the rationale for not carrying out this assessment.

iv. Certain Fund Managers limited their disclosures on the integration of sustainability risks to a statement outlining that such integration may be considered in the future. Other Fund Managers disclosed that they were committed to the promotion of ESG factors and the consideration of sustainability risks, but failed to provide details on the analyses performed, and their ability to assess the relevance of such risks. These disclosures, while indicating that Fund Managers seem willing to contribute to the ESG framework in the future, risk providing unclear and confusing information to investors.

v. The Authority also observed that some Fund Managers seemingly confused the notion of 'sustainability risks integration' with that of 'consideration of adverse impacts on sustainability factors'. An assessment of sustainability risks would encompass obtaining the necessary information to understand the effect of sustainability matters on the value of an investment. Consideration of adverse impacts refers to information about how an investment in a specific asset influences sustainability matters. Both notions revolve around the concept of 'double materiality'[6], which is a central component of the SFDR.

vi. In some cases, Fund Managers used the terms '*where appropriate/relevant/possible*' without elaborating on what would be regarded as appropriate/relevant/possible, when considering their size and line of business. The use of such terms resulted in vague and non-specific disclosures.

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[6] Double materiality is a concept which provides criteria for the determination of whether a sustainability matter has to be included in the Fund Manager's sustainability report. A sustainability matter meets the criteria of double materiality if it is material from either the impact perspective, the financial perspective, or both perspectives.

Expected Practices

Regardless of the financial product design and the target market, the SFDR requires Fund Managers to publish written policies on the integration of sustainability risks and to ensure the transparency of such integration. The relevant disclosures shall be accurate, fair, clear, comprehensible and concise, so that investors can understand the products and make informed decisions. This also reduces the risk of greenwashing.

Therefore, the Authority expects Fund Managers to consider the following recommendations with respect to the quality of the disclosures:

i. Fund Managers should assess whether any sustainability risks are present, and to what extent such risks can cause a material negative impact on the value of the investment. Such sustainability risks can either be physical or transitional. The assessment to determine the significance of sustainability risks shall be duly documented.

ii. The disclosures' wording and level of detail should be appropriate to the target audience, and mindful of the interests of the relevant stakeholders. This is especially crucial in the case of Fund Managers that offer financial products to retail investors.

iii. Overall, the disclosures should be specific to the financial products they relate to. The relevant disclosures should provide sufficient detail on how the sustainability risks are integrated, in a manner that is understandable to investors. Fund Managers are expected to conduct a risk assessment through a prism of their own business profile as well as the nature of their clients, which should be reflected in the disclosures in a clear and transparent manner. Such disclosures should also provide details on the investment strategies adopted by the relevant financial products.

   For a strategy to be clearly identified, at least some of the following non-exhaustive key elements should be considered and disclosed:

   - Investment universe (including limits and thresholds);
   - Screening criteria applied (negative/positive);
   - Specific ESG characteristics/themes or non-financial impacts pursued;
   - Use of benchmarks, ratings or indices and relative expected tracking error[7] (if applicable);

[7] Tracking error shows how often and how much portfolio of a financial product varies from its benchmark index.

- Stewardship approach to exercising voting rights in, and engagement with investee companies.

iv. Where a Fund Manager's assessment concludes that sustainability risks are relevant, the disclosures must contain information on the extent to which those sustainability risks might impact the performance of the financial product. Such information should be disclosed either in qualitative or quantitative terms.

v. Where a sustainability risk assessment concludes that there are no sustainability risks deemed relevant to the financial product, the reasons thereof should be explained in a clear and concise manner, with reference to the financial product in question.

Considerations regarding the applicable sustainability risks and their integration into a Fund Manager's decision-making shall be made while taking account of the size, nature and scale of the activities and the available financial products. The proportionality concept shall not justify the non-consideration of sustainability risks.

vi. To comply with their obligations under the SFDR, Fund Managers are expected to assess, on a continuous basis, not only all relevant financial risks but also all relevant sustainability risks that might have a material negative impact on the financial return of an investment.

vii. The information published on the website shall be kept up to date. Therefore, the website disclosures shall be dated, and any changes shall be clearly highlighted and explained.

viii. If a Fund Manager makes a forward-looking statement, such disclosure should also contain sufficient detail to substantiate the rationale behind the statement.

2.3 Consideration of Principal Adverse Impacts ("PAIs") of Investment Decisions on Sustainability Factors

Main Observations

i. 8 Fund Managers that were reviewed by the Authority declared that they considered the PAIs of their investment decisions on the sustainability factors in terms of Article 4(1)(a) of the SFDR. Most disclosures, however, could be improved further, mainly due to the absence of one or more elements that are set out in Article 4(1)(a).

A common finding was that PAI disclosures contained limited detail about specific sustainability factors that the Fund Managers identified as affected by its investment management activities. Additionally, no information was usually found regarding Fund Managers' adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting. The degree of their alignment with the objectives of the Paris Agreement was also not disclosed.

ii. With reference to Fund Managers that opted not to consider PAIs, the Authority noted that most of them neither provided clear and detailed reasoning for such decision, nor an indication as to when such adverse impacts are expected to be considered as part of the investment management process.

For instance, some Fund Managers disclosed that no consideration of PAIs was made, since such PAIs were not relevant to: (a) the asset composition of the client portfolios, or (b) the adopted investment strategies and/or policies. In such situations, the disclosures did not provide any information on the client portfolios and/or the investment strategies that would evidence PAIs as not relevant.

Common explanations that were provided by Fund Managers to justify not considering PAIs included, *inter alia*, the following: (a) challenging, uncertain and incomplete regulatory requirements, (b) lack of information and clear methodology on how to obtain data from issuers, (c) limited publicly available data, and (d) the application of proportionality criteria such as size, internal organisational setup, and the nature, scope and complexity of the activities in question.

Expected Practices

i. Starting from **1 January 2023**, Fund Managers that do consider the PAI of their investment decisions on sustainability factors are required to publish the information referred to in Article 4(1)(a) of the SFDR in a dedicated section titled 'Statement on principal adverse impacts of investment decisions on sustainability factors'.

Such Fund Managers should also be mindful that amendments to Commission Delegated Regulation (EU) No 231/2013 and Commission Directive 2010/43/EU were introduced with effect from **1 August 2022**.

Fund Managers are required to consider sustainability risks and PAIs of investment decisions on sustainability factors during the investment selection process, and as part of the ongoing monitoring of investments. Fund Managers are obliged to disclose how their due diligence policies take PAIs into account.

ii. Fund Managers that do not consider the adverse impacts of their investment decisions on sustainability factors should publish the information referred to in Article 4(1)(b) of the SFDR in a separate section of their website titled 'No consideration of adverse impacts of investment decisions on sustainability factors'.

iii. When providing reasons for considering or not considering PAIs, Fund Managers should include details pertaining to the financial products in question, particularly information on the composition of portfolios, and the investment strategies and/or policies.

iv. Where a Fund Manager states that it does not consider the PAIs of its investment decisions on sustainability factors based on the consideration of the entity's size, nature, scale of activities, client types, and/or investment strategies, the Fund Manager is expected to provide additional details on the factors that were considered to conclude that PAIs are disproportionate.

2.4 Remuneration Policy

Main Observations

Article 5 of the SFDR, which tackles the transparency of remuneration policies in relation to the integration of sustainability risks, requires Fund Managers to "*include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks*", which information shall be published on their websites.

The Authority observed that circa 30% of the reviewed Fund Managers failed to publish the required remuneration policy disclosures on their websites.

With reference to the available disclosures the Authority recognises the effort made by Fund Managers to comply with Article 5 of the SFDR. It is to be noted, however, that most of the reviewed disclosures were brief and, at times, unclear. In certain cases, the disclosures were limited to a statement that the Fund Manager's remuneration policy was consistent with its aim to integrate sustainability risks, however no additional details were provided in this regard. Other disclosures were limited to a statement confirming that the Fund Manager's approach to remuneration did not encourage excessive risk-taking with respect to sustainability risks.

The Authority also came across instances where disclosures about the integration of sustainability risks in the remuneration policy were only focused on the internal processes of the Fund Manager itself and did not reflect the consideration of sustainability risks pertaining to the financial products under management.

Expected Practices

The Authority acknowledges that certain provisions of the SFDR do not provide enough clarity on the scope of the disclosures. That said, one cannot dispute the fact that any website disclosures in terms of the SFDR shall be clear, transparent, and easily comprehensible.

In this respect, the Authority encourages Fund Managers to make an additional effort to improve the quality of disclosures pertaining to remuneration policies. For instance, where a Fund Manager discloses that there is no risk of misalignment of the remuneration policy with the integration of the sustainability risks in the investment decision making process, the disclosure should also explain the assessment made by the Fund Manager to arrive at that decision in the interest of transparency.

Fund Managers are reminded of the Board's overall obligation to have an approved structure regarding its policies for the remuneration and compensation of its management and staff members. The remuneration policy in place should be consistent with the objectives of the Fund Manager's business and risk strategy, including environmental, social and governance risk-related objectives, including those in relation to the long-term interests of the Fund Manager.

Fund Managers are further reminded that when, based on their assessment of the application of the proportionality principle, they seek a derogation from the requirements relating to the pay-out process, or the requirement to establish a remuneration committee, such assessment shall be reconcilable with the risk profile, risk appetite and the strategy of the entity and financial products it manages, and shall take into account sustainability risk.

A derogation from the requirements on the pay-out process and the establishment of a remuneration committee shall not exempt a Fund Manager from its disclosure obligations in terms of Article 5 of the SFDR.

Section 3: Concluding Remarks and Way Forward

The analysis of the website disclosures referred to herein, suggests that there is significant room for improvement on the quality and depth of the disclosures and the completeness of information provided. Overall, the Authority observed that the quality of the website disclosures varied substantially across the selected entities and could be characterised as lacking clarity and the required detail. In addition, the MFSA notes the cases of non-compliance in terms of failure to provide website disclosures by entities falling within the scope of the SFDR requirements.

In this respect, it is important that the in-scope entities shall take all necessary steps to ensure that they abide by all the applicable SFDR requirements, including website disclosures, which shall not only be published on the website, but also be made widely and publicly available and prominently and easily accessible. This means, for instance, that any SFDR disclosures published with limited access in a dedicated section of the website and that can only be viewed via an investor login shall not be considered acceptable. **Licence holders shall also take due consideration and ensure compliance with the SFDR RTS requirements, applicable from 1 January 2023. The Board of Directors shall also be informed on an ongoing basis of the extent to which the Licence Holder is compliant with the SFDR and the SFDR RTS.**

With reference to the Principal Adverse Impacts (in terms of Article 4 of the SFDR), while the SFDR requirements in this respect applied on a "*comply or explain basis*"[8] from 10 March 2021, additional details set out in the entity-level *'principal adverse sustainability impacts statement'* of the SFDR RTSs should apply from 1 January 2023.

Therefore, the entities that consider PAIs pursuant to Article 4(1)(a) of the SFDR are expected to have put in place the processes explaining how and when the quantitative data, required to complete the PAI Statement, is collected. By 30 June of each year starting from June 2023, such entities will be further required to publish a statement in the format set out in Annex 1 of the RTS under the section named:

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[8] Except for FMPs referred to in Article 4(3) and (4) of the SFDR who had the obligation to report from 30 June 2021.

"Statement on PAI of investment decisions on sustainability factors" of their website. The first statement should cover the information related to the 2022 calendar year.

With reference to the Fund Managers, the ESMA in its Supervisory briefing dated the 31 May 2022, explained that where "*sustainability risks have not been integrated throughout the organisation despite an appropriate period of time after entry into force of the AIFMD and UCITS amendments in this respect*", this would constitute a breach of the relevant legal framework.

In view of the above, the Authority expects Fund Managers to give sufficient priority to adapting their processes, systems and internal controls to reflect sustainability risks consideration. Fund Managers are also expected to develop the technical capacity necessary to analyse sustainability risks. It is expected that a Fund Manager's Board is provided with regular updates on the analyses of sustainable risks, and the impact of such risks on the performance of the financial products under management in line with the strategy, policies and objectives of the Fund**. The Board shall also be informed of the extent to which the Fund Manager is compliant with the SFDR and the SFDR RTS.**

The Authority also expects Fund Managers to regularly review their ESG policies and disclosures to ensure that they remain up-to-date and consistent with their risk appetite, financial products under management and the applicable regulatory obligations. It is recommended that this review is carried out at least on an annual basis.

With reference to sub-threshold AIFMs and self-managed Professional Investment Funds (PIFs), both of which were identified by the European Commission as falling within the scope of SFDR[9], the Authority recognises that the regulatory provisions for such entities are less stringent when compared to other regulated entities. The SFDR does not, however, distinguish between full-scope AIFMs and those entities subject to a national regime, and imposes the same level of requirements on all in-scope entities. Therefore, the governing body shall be responsible for ensuring compliance with the relevant provisions of the SFDR, including the consideration of

[9] For more details, please refer to the Commission's Q&A related to Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector issued on 14 July 2021.

sustainability risks in the investment management process and the creation of a website.

Fund Managers with mandates pertaining to Article 8 or Article 9 financial products are reminded of the requirement to further amend their website disclosures in line with the additional requirements emanating from the SFDR RTS, which came into effect on 1 January 2023. Article 23 of the SFDR RTS states that such disclosures shall be placed in a dedicated website section titled 'Sustainability-related disclosures'.

On a final note, the Authority expects all in-scope entities to which this Document is addressed to take due consideration of the recommendations from the initial study of the sustainability-related website disclosures outlined in this document and introduce necessary amendments to their existing disclosures and processes.

Separately, the Authority reminds the industry that the regulatory landscape in the area of sustainable finance is constantly developing with additional requirements having been added to the existing legal framework as of August 2022.[10] The entities are therefore expected to give prominence and actively consider the impact of climate-related and other environmental risks on their activities in short, medium, and long term strategic and business decisions.

Contacts

In case of queries with respect to the above, please do not hesitate to contact the Authority on sustainable.finance@mfsa.mt.

[10] In particular, a number of provisions within Commission Delegated Regulation (EU) No 231/2013 and Commission Directive 2010/43/EU have been amended, and now require in-scope Fund Managers to take into account sustainability risks and PAIs (where relevant) during the initial and on-going due diligence carried out as part of the investment decision-making process.

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